NOTES

WASHINGTON NOTES

"DEMOBILIZING" INDUSTRY

Rapid changes in the system of government control of industry have occurred during the month of December, the process of return to a normal condition of business being now far advanced on the road to completion. Price-fixing in the steel industry has been ordered terminated on the first of January. A large quantity of shipping has been released by the government for commercial use. Restrictions upon the consumption of food have been in part relaxed, the limitations upon the shipment of fuel and materials have been greatly reduced, the early disestablishment of the food and fuel administrations has been announced, modifications in the system of controlling imports and exports have been determined upon, and the export license plan modified accordingly. All this has brought about a great release of business energy and a greater progress toward the re-establishment of a democratic form of government and of business.

In consequence of these changes, business now finds it necessary to recognize the problem of price changes which was non-existent so long as government price-fixing prevented fluctuations. There has been a tendency of prices downward from the high level reached at about the end of October, and the cancellation of a great many contracts for war materials, since the conclusion of the armistice, has tended to accentuate this downward movement. It will be furthered by the unavoidable action of the government in disposing of the surplus or excess stocks of goods which the various departments now have on hand and which they will have to dispose of in such a way as to restore the goods to civilian use at as early a moment as practicable.

On the other hand the question of eliminating the remainder of our restrictive regulations and of getting back to a condition of competitive business will necessarily depend in considerable degree upon the extent to which we are able to reach a common understanding with foreign countries. This common understanding will necessarily involve a regulation of the distribution of gold supplies and the devising of some means for establishing stable rates of exchange between the United States

and other countries through the working out of some joint plan of action as to currency and bank credits. Precisely what this can be will not be known until after the announcement of the results of the peace conference, and the economic adjustments which are to occur as a result of that conference. When these are announced it will be clear how far we may expect to resume relations with foreign countries based on freedom of trade and the free transmission and movement of gold. This merely amounts to saying that a considerable proportion of our government regulation of business cannot be entirely disposed of until the advice and co-operation of other countries has been obtained, to the end that there may be joint action in bringing about the restoration of the older conditions.

Moreover, the after-war problems of what is called "reconstruction" cannot, it is now seen, be even tentatively disposed of until much more progress has been made toward the re-establishment of normal conditions in industry. This is contrary to what has been supposed, for it has been evident for some time past that there was a large element among public officers who expected to see the reconstruction process carried out under bureaucratic supervision. Public opinion, however, has been too strong for the adoption of this method of transition, and, in lieu thereof, has come the recognition that what is done must be accomplished largely by individual initiative under, at most, the general regulation of the authorities of the government.

CONTRACTING CREDIT

It is thus already apparent that one of the principal problems of the reconstruction period which is now opening will be that of determining whether the banking policy of the country shall be that of contraction of credits or of further expansion of prices and advances as well as of wages. One of the phenomena which has caused most anxiety during the latter part of the war has been that of the use of paper secured by government bonds and certificates of indebtedness for the purpose of obtaining accommodation from banks for use in connection with commercial business of various kinds. At first the low rate of discount fixed by the banks for paper protected by government obligations was probably availed of only for the purpose of carrying these obligations until they could be settled—the end for which the rate was originally established. In the later liberty loans there developed a tendency to subscribe for bonds and then to obtain banking aid in carrying such

loans, while many of those who thus subscribed nevertheless held out their own current funds for use in business. During the fourth liberty loan and since its conclusion there has been an increasing tendency to obtain direct loans from reserve banks collateraled by government obligations; and in some cases government bonds have been actually borrowed from their owners in order that they might be employed by those who borrowed them as collateral at Federal Reserve banks, thus enabling the makers of such notes to get the low rate of discount offered for government bond-secured paper.

This situation and others closely connected with it seem likely to present the first serious practical problem which must be dealt with in the effort to get back to a normal basis of credit and banking. How to eliminate the so-called "war paper" from the portfolios of the banks will be a question calling both for careful handling and for courage, inasmuch as the elimination of such paper will perhaps do more than anything else to restore the price level to something approximating its former position. The opposition of business men to any reduction of prices is always evident after the close of a war and is being clearly exhibited at the present time, although in ways that differ from those that have been most commonly recognized in former wars. The combinations of manufacturers for the purpose of sustaining prices temporarily at the level fixed under government price-fixing are now frequent, and the opposition to what is called "contraction" as tending to lower both wages and prices is also very general.

The first step has, however, already been taken by the Federal Reserve Board which, in a letter to Federal Reserve banks (*Federal Reserve Bulletin*, December, 1918, page 1169), urged upon them that they attempt to curtail the unreasonable applications for loans being made by some members in different parts of the country who had not hesitated to obtain large volumes of rediscounts simply for the purpose of meeting the demands of current profit-making business. It was the view of the Board that unrestrained rediscounts of this kind, coming at a time when credit was already unavoidably scanty, could not be otherwise than injurious, as well as unfair, to those who had exercised a greater degree of restraint and who were therefore not applicants for this kind or volume of accommodation. Time has not yet been sufficient to ascertain what the effect of the warning will be, but the general policy which is thus presented is clearly the effective means of bringing about an improvement in existing credit conditions.

THE FISCAL SITUATION

Developments in public finance during the month of December have given a new turn to the problems already recognized at the time of the conclusion of the armistice with Germany. An announcement made by the Secretary of the Treasury on December 14 had already limited the fiscal requirements for the current year to $18,000,000,000 and had rendered possible a modification of the war revenue bill to correspond thereto. Accordingly on December 6 the war revenue bill was reported by the Senate Finance Committee in a form which supposedly provides for an income of $6,000,000,000 instead of the $8,000,000,000 or $9,000,000,000 originally intended. This is substantially a cut in the proportion originally planned by the Secretary of the Treasury when he formulated the program of $2.00 in loans for every $1.00 raised in taxation. The proposal at the opening of the year having been $24,000,000,000, of which $8,000,000,000 were to come from taxation, a reduction to $18,000,000,000 would mean a reduction of $2,000,000,000 in taxation.

This reduction, however, has been effected in such a way as to be comparatively obscure to the average man. The income tax remains practically as formulated by the House of Representatives with a normal rate of 12 per cent, reduced on incomes below $4,000 to 6 per cent and with supertaxes running from 1 per cent up to 65 per cent. The excess-profits tax is now modified and simplified but may conceivably go to 80 per cent in the case of certain classes of concerns. There is therefore no perceptible lightening in either income or excess-profits taxes. The excise or consumption taxes have, however, been materially reduced in number and to some extent in severity, while it is recognized that, due to the prohibitions upon the manufacture of spirits and beer, the income derived from these sources will decline from now on.

Practically simultaneously with the reporting of the war revenue bill the Secretary of the Treasury has called upon Congress, in a letter bearing the date of December 11, to extend the power of making loans and advances to allied countries, in order that this policy may be continued in time of peace on the same basis as in time of war. Almost at the same time, too, it has been made known that the next or fifth liberty loan will be offered in the early spring of 1919 and will consist of short-term obligations, probably bearing a higher rate of interest than those of the fourth liberty loan. What this rate will be is not stated, but the unofficial intimations place it at $4\frac{1}{2}$ to 5 per cent, probably without exemption from taxation, that figure being thought necessary to make

the loan acceptable to investors. It is believed that the amount of the loan will be in the neighborhood of $6,000,000,000, and this in itself implies the necessary continuance of war financing for a good many months to come, pending not only the placing of the bonds of the fifth liberty loan but their eventual absorption by the investors of the country.

In the meantime the question whether new and heavier demands would be brought to bear upon the banks as the result of the so-called reconstruction process, and whether the banks in attempting to meet them may not be driven to the adoption of measures which would practically result in further inflation, is probably the most pressing question of a banking kind that is now open. This makes acute the problem of financing the next loan by a process of saving rather than by a process of expansion of bank credit. The choice between the two methods will evidently depend in considerable degree upon the rates of interest and discount that may be established during the next few months.

FINANCE REPORT FOR 1918

The publication of the report of the Secretary of the Treasury for the past year (*Finance Report*, 1918) presents the history of a financial period possessed of remarkable interest and embodying the results of probably the largest fiscal and banking operations in history. This report covers the period of the third and fourth liberty loans and covers the great growth in Federal Reserve operations contemporaneous or coincident with them. The document also covers very extensive reorganizations and enlargements in the various financial services which have grown out of the war, such as the Bureau of War Risk Insurance, as well as a variety of others.

It is, of course, not possible at this time to forecast the financial requirements for the coming year even with the degree of accuracy which has sometimes been attained, so that the report is necessarily more truly a historical document than it is a forecast of policy or a discussion of methods to be pursued. Some of the financial expedients of the past year to which reference is particularly made, such as the gold embargo, the control of foreign exchange, and others, are of large interest, and the results tentatively set forth throw light upon the plans and purposes which gave rise to the various measures adopted. The review of experience with the Federal Reserve System and the War Finance Corporation is perhaps less adequate and satisfactory than other portions

of the discussion, due to the fact that the Treasury Department was able to commit the management of these branches of government administration to others, thereby relieving itself of the responsibility but being also correspondingly limited in its information and insight into the situation relating to these branches of finance. The *Finance Report* for 1918 will nevertheless doubtless stand permanently as a document of first-class importance in American fiscal history.

THE RAILROAD PROBLEM

Further progress in the development of the railroad policy of the nation has been brought about during the past month as a result of three important events: (1) the announcement of the policy of President Wilson in his message to Congress of December 2; (2) the appointment of a representative committee of railway executives at a meeting held in New York on November 4, for the purpose of considering railroad relationships to the government; and (3) the announcement by the Secretary of the Treasury, in a letter to the Chairman of the House Interstate Commerce Committee, bearing date of December 11, to the effect that a further five-year period of control by the government would be necessary in order to bring about a satisfactory settlement of the essentials of the situation.

President Wilson in his message to Congress on December 2 expressly stated that he had no definite plans in the matter, saying: "I have no confident judgment of my own. I do not see how any thoughtful man can have who knows anything of the complexity of the problem. . . . . The only thing that is perfectly clear to me is that it is not fair either to the public or to the owners of the railroads to leave the question unanswered [what should be done with the roads in the interest of the public and in fairness to their owners], and that it will presently become my duty to relinquish the control of the roads even before the expiration of the statutory period unless there should appear some clear prospect in the meantime of a legislative solution." The Secretary of the Treasury in his letter of December 11, on the other hand, stated plainly that only three courses with reference to the railroads are now open:

1. Government operation of the railroads for one year and nine months following a proclamation of peace. . . . .
2. The prompt return of the railroads to private control; or
3. Extension of the period of federal control to five years.

Mr. McAdoo further stated that in his opinion the third alternative was the only one that was now at all workable, and that unless it were

resorted to an early return of the roads to their owners would be unavoidable. The attitude of the railroad executives at the meeting already referred to and in other expressions has been to the effect that they did not want the lines returned to their unrestricted control until such time as legislation had been obtained for the definite settlement and adjustment of problems whose existence, in their opinion, would render private control and management of the carriers entirely unsuccessful were they to be returned to their former status.

Specifically, the difficulties in the present railroad problem are reducible to the fact that whereas under government control wages have been immensely raised, freights and fares have been raised in a much smaller degree, so that continued profitable operation of the roads under existing conditions is practically out of the question if they are to be properly carried on. Railroad men, moreover, are extremely reluctant to subject themselves again to the difficulties which they had to contend with during the two years prior to the date when the government assumed control. It was then impossible to obtain new capital, owing to the fact that the public at large was not willing to trust them with their funds, due to the evident intention of the Interstate Commerce Commission not to permit any advances in rates. The rate legislation of the past few years, as applied by the Commission, had in fact become so rigid and burdensome as to be for several of the lines almost impossible of application consistently with prosperity.